

MONTALVO ASSOCIATION
(A CALIFORNIA NONPROFIT
PUBLIC BENEFIT CORPORATION)

FINANCIAL STATEMENTS

SEPTEMBER 30, 2012
(WITH COMPARATIVE TOTALS FOR 2011)

ARMANINO MCKENNA ^{LLP}
Certified Public Accountants & Consultants



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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Montalvo Association
Saratoga, California

We have audited the accompanying statement of financial position of Montalvo Association ("Montalvo") as of September 30, 2012 and the related statements of activities, cash flows, and functional expenses for the year then ended. These financial statements are the responsibility of Montalvo's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from Montalvo's 2011 financial statements which were audited by other auditors whose report dated January 9, 2012 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Montalvo's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montalvo as of September 30, 2012 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Armanino McKenna LLP
ARMANINO McKENNA LLP

January 16, 2013



MONTALVO ASSOCIATION
Statement of Financial Position
September 30, 2012
(With Comparative Totals for 2011)

<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Current assets		
Cash and cash equivalents	\$ 590,129	\$ 350,378
Accounts receivable	79,683	14,329
Current portion of pledges receivable	815,652	932,500
Current portion of grants receivable	200,000	197,500
Prepaid expenses	<u>139,220</u>	<u>137,922</u>
Total current assets	<u>1,824,684</u>	<u>1,632,629</u>
Investments	6,684,287	1,546,217
Pledges receivable, net of current portion	2,430,106	1,564,105
Property and equipment, net	<u>8,777,146</u>	<u>8,917,599</u>
 Total assets	 <u>\$ 19,716,223</u>	 <u>\$ 13,660,550</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities		
Accounts payable	\$ 201,883	\$ 109,302
Accrued expenses	210,099	209,941
Deposits	24,000	10,500
Deferred revenue	<u>308,479</u>	<u>240,505</u>
Total current liabilities	<u>744,461</u>	<u>570,248</u>
Net assets		
Unrestricted net assets		
Montalvo Service Group	210,237	135,424
Unrestricted net assets	<u>8,822,458</u>	<u>9,440,465</u>
Total unrestricted net assets	9,032,695	9,575,889
Temporarily restricted net assets	1,287,694	2,763,156
Permanently restricted net assets	<u>8,651,373</u>	<u>751,257</u>
Total net assets	<u>18,971,762</u>	<u>13,090,302</u>
 Total liabilities and net assets	 <u>\$ 19,716,223</u>	 <u>\$ 13,660,550</u>

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION
Statement of Activities
For the Year Ended September 30, 2012
(With Comparative Totals for 2011)

	2012			2011	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Support and revenue					
Support					
Individuals	\$ 887,625	\$ 63,090	\$ 135	\$ 950,850	\$ 2,635,621
Grants and contributions	211,645	1,292,508	6,399,981	7,904,134	468,584
Contributions in-kind	706,019	-	-	706,019	179,810
Special events (includes in-kind contributions of \$83,256 and \$67,807)	631,959	1,100	-	633,059	406,116
Less: direct expenses	(174,961)	-	-	(174,961)	(173,932)
Total support	<u>2,262,287</u>	<u>1,356,698</u>	<u>6,400,116</u>	<u>10,019,101</u>	<u>3,516,199</u>
Revenue					
Rentals	546,122	-	-	546,122	594,222
Arts programs	680,761	-	-	680,761	940,558
Dividends and interest	30,495	7,121	-	37,616	43,019
Concessions and merchandise	87,225	-	-	87,225	82,654
Net realized and unrealized gain (loss) on investments	172,986	19,164	-	192,150	(25,165)
Other income	517	-	-	517	1,522
Total revenue	<u>1,518,106</u>	<u>26,285</u>	<u>-</u>	<u>1,544,391</u>	<u>1,636,810</u>
Total support and revenue	3,780,393	1,382,983	6,400,116	11,563,492	5,153,009
Net assets released from restrictions	<u>1,358,445</u>	<u>(1,358,445)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total support, revenue and net assets released from restrictions	<u>5,138,838</u>	<u>24,538</u>	<u>6,400,116</u>	<u>11,563,492</u>	<u>5,153,009</u>
Expenses					
Program services	<u>4,467,942</u>	<u>-</u>	<u>-</u>	<u>4,467,942</u>	<u>3,882,600</u>
Supporting services					
Management and general	747,452	-	-	747,452	582,899
Fundraising	466,638	-	-	466,638	582,492
Total supporting services	<u>1,214,090</u>	<u>-</u>	<u>-</u>	<u>1,214,090</u>	<u>1,165,391</u>
Total expenses	<u>5,682,032</u>	<u>-</u>	<u>-</u>	<u>5,682,032</u>	<u>5,047,991</u>
Change in net assets before changes related to collection items not capitalized and changes in donor-imposed restrictions	(543,194)	24,538	6,400,116	5,881,460	105,018
Change in donor-imposed restrictions (Note 4)	-	(1,500,000)	1,500,000	-	-
Collection items purchased	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(10,500)</u>
Change in net assets	(543,194)	(1,475,462)	7,900,116	5,881,460	94,518
Net assets, beginning of year	<u>9,575,889</u>	<u>2,763,156</u>	<u>751,257</u>	<u>13,090,302</u>	<u>12,995,784</u>
Net assets, end of year	<u>\$ 9,032,695</u>	<u>\$ 1,287,694</u>	<u>\$ 8,651,373</u>	<u>\$ 18,971,762</u>	<u>\$ 13,090,302</u>

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION
Statement of Functional Expenses
For the Year Ended September 30, 2012
(With Comparative Totals for 2011)

	Program Services	Supporting Services			Total	
		Management and General	Fundraising	Total	2012	2011
Expenses						
Salaries and wages	\$ 1,454,600	\$ 473,765	\$ 214,894	\$ 688,659	\$ 2,143,259	\$ 1,977,275
Payroll taxes and employee benefits	311,390	65,402	42,648	108,050	419,440	373,110
Total salaries and related expenses	1,765,990	539,167	257,542	796,709	2,562,699	2,350,385
Donated goods / services	527,982	45,093	108,524	153,617	681,599	57,288
Artist fees / hospitality	488,920	-	-	-	488,920	728,943
Advertising and publicity	258,939	180	-	180	259,119	142,222
Maintenance	196,890	9,188	1,659	10,847	207,737	216,568
Costs of sales	91,451	4,350	14,592	18,942	110,393	33,891
Production	82,545	9,437	-	9,437	91,982	350,337
Utilities	83,942	3,959	3,959	7,918	91,860	107,129
Printing and publication	77,651	1,650	4,343	5,993	83,644	49,153
Professional fees	16,046	59,867	2,850	62,717	78,763	42,098
Insurance	65,381	3,084	3,084	6,168	71,549	77,472
Supplies	57,380	2,706	2,706	5,412	62,792	39,779
Cultivation / hospitality	30,880	17,848	6,016	23,864	54,744	34,021
Transportation / vehicles	54,156	-	-	-	54,156	4,308
Consultants	18,343	1,000	21,297	22,297	40,640	81,272
Postage and shipping	21,808	4,290	3,281	7,571	29,379	30,911
Telephone	22,460	3,114	3,173	6,287	28,747	23,243
Conferences, training, dues, subscription	10,903	12,223	4,093	16,316	27,219	12,414
Repairs	16,058	-	-	-	16,058	12,252
Property tax	12,952	611	611	1,222	14,174	15,950
Office supplies	8,537	1,184	1,206	2,390	10,927	7,619
Travel	3,525	2,315	534	2,849	6,374	3,889
Miscellaneous	-	-	982	982	982	4,998
Total expenses before depreciation	3,912,739	721,266	440,452	1,161,718	5,074,457	4,426,142
Depreciation	555,203	26,186	26,186	52,372	607,575	621,849
Total functional expenses	\$ 4,467,942	\$ 747,452	\$ 466,638	\$ 1,214,090	\$ 5,682,032	\$ 5,047,991
Percentage of total	79%	13%	8%	21%	100%	

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION
Statement of Cash Flows
For the Year Ended September 30, 2012
(With Comparative Totals for 2011)

	2012	2011
Cash flows from operating activities		
Change in net assets	\$ 5,881,460	\$ 94,518
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities		
Depreciation	607,575	621,849
Net realized and unrealized (gain) loss on investments	(192,150)	25,165
Donated property and equipment	(107,676)	(125,072)
Contributions restricted for long-term purposes	(250,000)	-
Permanently restricted endowment contribution	(5,000,000)	(100,000)
Changes in operating assets and liabilities		
Accounts receivable	(65,354)	(13,309)
Pledges receivable	(749,153)	(939,253)
Grants receivable	(2,500)	228,462
Prepaid expenses	(1,298)	(102,814)
Accounts payable	92,581	50,326
Accrued expenses	158	43,206
Deposits	13,500	500
Deferred revenue	67,974	6,237
Net cash provided (used) by operating activities	295,117	(210,185)
Cash flows from investing activities		
Purchase of property and equipment	(359,446)	(155,332)
Purchases of investments	(6,401,385)	(341,918)
Proceeds from sales of investments	1,455,465	238,967
Net cash used by investing activities	(5,305,366)	(258,283)
Cash flows from financing activities		
Contributions restricted for long-term purposes	250,000	-
Permanently restricted endowment contribution	5,000,000	100,000
Net cash provided by financing activities	5,250,000	100,000
Net increase (decrease) in and cash equivalents	239,751	(368,468)
Cash and cash equivalents, beginning of year	350,378	718,846
Cash and cash equivalents, end of year	\$ 590,129	\$ 350,378
<u>Supplemental disclosure of cash flow information</u>		
Cash paid for interest	\$ 931	\$ -

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

1. Organization

Historically known as Villa Montalvo, Montalvo Arts Center, ("Montalvo Association" or "Montalvo"), is located on the 175-acre summer estate built in 1912 by James Duval Phelan (1861-1930). Phelan, a passionate Californian who had been a three-term progressive mayor of San Francisco, went on to become California's first popularly-elected U.S. Senator. Villa Montalvo was Senator Phelan's favorite home and a center of artistic, political and social life in Northern California. He invited leading writers and artists to Villa Montalvo to work on individual artistic projects in an environment rich in dialogue and fellowship. At his death, Senator Phelan bequeathed Montalvo to the people of California to serve as a site for the advancement of art, music, literature and architecture, a legacy that continues to this day.

For 100 years, Montalvo Arts Center has served the Silicon Valley as a center of creativity and has offered a wide range of exceptional opportunities for involvement with the arts to diverse audiences. Through the architecturally distinguished Sally and Don Lucas Artists Residency program, the performing arts series, visual arts, public programming and exhibitions program, literary arts events, and education and outreach programs, Montalvo successfully connects the larger national and international arena of exemplary artistic talent with the Silicon Valley community. In its role as a contemporary arts center, Montalvo fosters creativity, nurtures new talent and spurs active engagement with the arts through commissions of new work, presentation of acclaimed and emerging artistic talent, and implementation of its arts education and outreach initiative. Relevance to the community is key.

At the heart of Montalvo Arts Center is the Sally and Don Lucas Artists Residency Program. This internationally recognized program sets Montalvo apart by enhancing its ability to contribute to the field through the creation of new work by accomplished artists and creative thinkers, serving as the driving force behind its community-based outreach programs, and giving California artists the opportunity to work in close collaboration with peers from around the globe.

2. Program Services

Sally and Don Lucas Artists Residency Program

The Lucas Artists Residency Program offers selected artists private housing, a professional staff that is supportive of the creative process, state-of-the-art technology, and an environment conducive to both individual practice, community engagement and the energetic exchange of ideas among international and culturally diverse Fellows.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

2. Program Services (continued)

Performing Arts Series

The lively performing arts program consists of more than 40 music concerts and theatrical performances presented in the 1200-seat Garden Theatre and the intimate, 300-seat Carriage House Theatre. In 2009, a Villa Chamber Music Series began in the Grand Hall of the Villa. Montalvo also presents children's performing arts programs in the Carriage House Theatre. Through the artists residency program, Montalvo commissions composers to create new works of contemporary classical music.

Visual Arts Public Programming and Exhibition

The visual arts program encompasses a year-round series of exhibitions exploring all media mounted in the Project Space gallery, arts related community programs, and Sculpture on the Grounds, which includes both existing and commissioned works of art installed throughout the property.

Education and Outreach

The education programs serve 15,000 students annually and consist of a broad range of arts-related programs, classes and special events for all ages. Education programming includes the Family Performing Arts Series, Master Class series taught by resident artists and exhibiting artists, professional development for teachers, student school programs, visual and performing arts camps, Teaching Artist Fellowships, and the Wells Fargo Performing Arts Series for Students.

Historic Villa and Extant Buildings

Anchored by the historic Villa Montalvo and the Sally and Don Lucas Artists Residency Program compound of studios, the complex also includes new and historic buildings on the Montalvo grounds. Docent-led tours of the Villa and grounds are available to the public.

Gardens and Grounds

The formal Italianate gardens, historic Cactus Garden, the Oval Garden, the Love Temple, and multiple hiking trails comprise the estate's 175-acre grounds.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

3. Summary of Significant Accounting Policies

Basis of presentation

The financial statements of Montalvo Association have been prepared on the accrual basis of accounting. Net assets and changes therein are classified as follows:

- Permanently restricted net assets - represent contributions generally to be held in perpetuity as directed by the donors. The income from these contributions is available to support activities of Montalvo as designated by the donors.
- Temporarily restricted net assets - represent contributions whose use by Montalvo is limited in accordance with temporary donor-imposed stipulations. These stipulations may expire with time or may be satisfied by the actions of Montalvo according to the intentions of the donors.
- Unrestricted net assets - represent unrestricted resources available to support Montalvo's operations and temporarily restricted resources that have become available for use by Montalvo in accordance with the intentions of the donors. Under this category, Montalvo maintains an operating fund, property and equipment fund plus any net assets designated by the Board for specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related asset is limited by donor-imposed restrictions. Montalvo recognizes support from temporarily restricted net assets when the restrictions imposed by the donors have been satisfied or expired. Expenses are reported as decreases in unrestricted net assets. Gains and losses on assets and liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor restriction or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Revenue from grants which have been classified as "exchange transactions" and program fees are recognized as revenue in the period in which the service is provided.

Comparative financial information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class or functional expense categories. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with Montalvo's financial statements for the year ended September 30, 2011, from which the summarized information was derived. Certain balances as of September 30, 2011 were reclassified to conform to the 2012 financial statement presentation. The reclassifications were immaterial to the financial statements as a whole.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

3. Summary of Significant Accounting Policies (continued)

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of support, revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. Montalvo maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. Montalvo has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Pledges and grants receivables

Unconditional promises to give are recorded at their net realizable value. If such promises to give are due in more than one year, they are discounted to the present value of their estimated future cash flows using a market rate. Reserves for potential uncollectable contributions receivable are maintained based on historical credit losses and management's expectations. Montalvo uses the allowance method to reserve for uncollectible receivables. The allowance is based on prior years' experience and management's analysis of specific promises made by the donors. As of September 30, 2012, Montalvo considers all pledges and grants receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary.

Conditional promises to give, if any, are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Investments

Investments consist of domestic and international marketable equity securities, debt securities, and certificates of deposit with original maturity dates greater than three months. All investments are stated at fair values using quoted market prices. Unrealized gains and losses are included in the statement of activities. Investment income and gains restricted by a donor are reported as increases in restricted net assets.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

3. Summary of Significant Accounting Policies (continued)

Fair value measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. In determining fair value, Montalvo uses various valuation approaches. A hierarchy has been established for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of Montalvo. Unobservable inputs are inputs that reflect Montalvo's assumptions about what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of financial instruments:

Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect Montalvo's estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Property and equipment

Property and equipment are recorded at cost or estimated fair value for donated items. Equipment purchases over \$5,000 are capitalized. The cost of repairs and maintenance which do not improve or extend the lives of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 30 years. Depreciation is charged to the activity benefiting from the use of the property or equipment.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

3. Summary of Significant Accounting Policies (continued)

Long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Recoverability of assets is measured by comparison of the carrying amount of the asset to the net undiscounted future cash flows expected to be generated from the asset. If the future undiscounted cash flows are not sufficient to recover the carrying value of the assets, the assets' carrying value is adjusted to fair value. Donated equipment is recorded as a contribution at its estimated fair value on the date of receipt. Such donations are reported as unrestricted support unless the donor has restricted the donated asset for a specific purpose. Absent explicit donor stipulations about how long those long-lived assets must be maintained, Montalvo reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Collections

Collection items acquired either through purchase or donation are not capitalized. Purchases of collection items are recorded as decreases in unrestricted net assets if purchased with unrestricted assets and as decreases in temporarily restricted or permanently restricted net assets if purchased with donor-restricted assets. Contributions of collection items are not recognized in the statement of activities. Proceeds from deaccessions or insurance recoveries are reflected in the statement of activities based on the absence or existence and nature of donor-imposed restrictions.

Deferred revenue

Montalvo receives payments during the year in advance for various performances and for park rental. As of September 30, 2012, \$308,479 had not been earned and has been recorded as deferred revenue.

Contributions in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. The contributions of goods and services are recognized if they (a) create or enhance nonfinancial assets or (b) require specialized skills that are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. Montalvo also receives donated services that do not require specific expertise but which are nonetheless central to Montalvo's operations. While these contributed services are not reflected in the financial statements the estimated value of these services is disclosed in Note 10.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

3. Summary of Significant Accounting Policies (continued)

Functional expense allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Indirect expenses are allocated based upon estimated functional usage by time, square footage or other appropriate means.

Income taxes

Montalvo Association is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements. In addition, Montalvo qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Montalvo evaluated its current tax positions and has concluded that as of September 30, 2012, Montalvo does not have any significant uncertain tax positions for which a reserve or disclosure would be necessary.

Advertising

Montalvo's policy is to expense advertising costs as the costs are incurred. Advertising expense for the year ended September 30, 2012 was \$259,119.

4. Pledges and Grants Receivable

Pledges and grants receivable consisted of the following at September 30, 2012:

Due in less than one year	\$1,015,652
Due in one to five years	2,040,000
Due in more than five years	<u>500,000</u>
Total	3,555,652
Less: discount on multi-year contributions receivable	<u>(109,894)</u>
Contributions receivable, net	3,445,758
Less: current portion	<u>(1,015,652)</u>
Contributions receivable, noncurrent, net of discount	<u>\$2,430,106</u>

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

4. Pledges and Grants Receivable (continued)

For pledges and grants expected to be collected in more than one year a present value discount is estimated based on an applicable market rate at the time of the promise as adjusted for credit and other donor specific risks. The risk-adjusted discount rates on pledges and grants receivable as of September 30, 2012 ranged from 0.22% to 4.0%.

In 2010, Montalvo received a multi-year temporarily restricted contribution which held a \$1,500,000 outstanding balance as of September 30, 2011. During 2012, the donor notified Montalvo that they were modifying the terms of the pledge by increasing the remaining balance to \$8,000,000 and stipulated that the pledge be restricted for the purposes of Montalvo's permanent endowment. Montalvo recorded permanently restricted contribution revenue of \$6,500,000 and a change in donor-imposed restrictions of \$1,500,000 during the year ended September 30, 2012 as presented in the accompanying statement of activities. As of September 30, 2012, the aforementioned pledge has an outstanding receivable balance of \$3,000,000 to be fulfilled in annual installments of \$500,000. The discount to present value associated with this receivable was \$100,019 as of September 30, 2012.

5. Investments

Montalvo Association's investments are recorded at fair value and have been categorized based upon a fair value hierarchy. Investments held at September 30, 2012 are valued using Level 1 inputs (see Note 3), and were as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$4,301,274	\$ -	\$ -	\$4,301,274
Common stock	329,633	-	-	329,633
Domestic equity funds	782,344	-	-	782,344
International equity funds	572,263	-	-	572,263
Domestic bond funds	676,593	-	-	676,593
Certificates of deposit	<u>22,180</u>	<u>-</u>	<u>-</u>	<u>22,180</u>
Total	<u>\$6,684,287</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$6,684,287</u>

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2012

6. Property and Equipment

The cost and related accumulated depreciation of property and equipment at September 30, 2012 consisted of the following:

Artists residency	\$ 8,603,725
Building improvements	4,585,872
Carriage house	1,263,208
Office equipment	678,779
Building improvements - East Wing	534,755
Gallery	465,292
Furniture and fixtures	392,586
Land improvements	253,242
Construction in progress	128,197
Vehicles	71,116
Land	<u>53,000</u>
	17,029,772
Less: accumulated depreciation and amortization	<u>(8,252,626)</u>
Property and equipment, net	<u>\$ 8,777,146</u>

Property and equipment have been recorded at cost, or fair value if donated, together with related depreciation expense. Montalvo's policy is to remove property and equipment from the accounts once they have been fully depreciated. Depreciation expense for the year ended September 30, 2012 was \$607,575.

7. Credit Facility

At September 30, 2012, Montalvo had an available line of credit to finance operations in the amount of \$250,000. The line of credit bears interest at the U.S. prime rate plus 1%. As of September 30, 2012, the interest rate was 4.25%. The line of credit was renewed on January 15, 2013 for an additional twelve month period and is secured by Montalvo assets. At September 30, 2012, there was no outstanding balance on the line of credit.

8. Temporarily Restricted Net Assets

Montalvo's temporarily restricted net assets consistent of the following as of September 30, 2012:

Purpose restrictions	
Capital projects	\$ 705,233
Other	10,279
Time restrictions	532,624
Endowment earnings	<u>39,558</u>
Total temporarily restricted net assets	<u>\$1,287,694</u>

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8. Temporarily Restricted Net Assets (continued)

Net assets were released from restrictions during the year by incurring expenses satisfying the restricted purpose or the occurrence of other events specified by donors during the year ended September 30, 2012 as follows:

Purpose restriction	\$ 983,044
Time restriction - general support	<u>375,401</u>
Total net assets released from restrictions	<u>\$1,358,445</u>

9. Endowment

The Montalvo Endowment Fund consists of its donor-restricted endowment fund. Net assets associated with these endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The permanently restricted net assets of these funds consist of the following on September 30, 2012:

Lucas Artists Program	\$7,900,116
General operations	<u>751,257</u>
Total	<u>\$8,651,373</u>

Interpretation of relevant law

The Board of Trustees of Montalvo has interpreted the California version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Montalvo classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Montalvo in a manner consistent with the standard of prudence prescribed by the California version of UPMIFA.

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9. Endowment (continued)

Interpretation of relevant law (continued)

In accordance with the California version of UPMIFA, Montalvo considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of Montalvo and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of Montalvo
7. The investment policies of Montalvo

Investment return objectives, risk parameters and strategies

The primary objective for Montalvo's investment policy has been to employ a total return approach to achieve long-term growth with meaningful exposure to equities, placing current income as a secondary consideration. This is consistent with the original investment goals of preservation of the purchasing power of capital and the construction of a well-diversified, high-quality investment portfolio. Currently the target asset allocation is approximately 50% equities. The minimum total return objective over a market cycle (3-5 years) has been to exceed the inflation rate by 3% net of fees. The investment time horizon for the fund is long. Historically, the fund has possessed an above average tolerance for risk as defined by the ability to withstand moderate fluctuations in account value over a market cycle. This is in keeping with the objective of growth within long term horizons.

Spending policy and how the investment objectives relate to spending policy

In accordance with, and subject to, the principal requisite UPMIFA factors set forth above, Montalvo's distribution guidelines shall be as follows:

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9. Endowment (continued)

Spending policy and how the investment objectives relate to spending policy (continued)

Montalvo's Finance Committee may authorize disbursement each year, for the general budgetary purposes of Montalvo, up to four percent (4%) of the fair market value (determined on the average fair market value of the prior 12 quarters through the fiscal year preceding the fiscal year in which the distribution is planned) from the donor-restricted endowment fund. In the event that income from the donor-restricted endowment fund exceeds four percent (4%) in any given year, Montalvo's Board of Trustees shall have the discretion whether to disburse such excess up to an amount not to exceed seven percent (7%) of the donor-restricted endowment fund's average fair market value of the prior 12 quarters as described above. For the purposes of this paragraph the term "income" shall include, but not be limited to interest, dividends and appreciation of assets within the donor-restricted endowment fund. In addition, no borrowing from the donor-restricted endowment fund may be allowed at any time. Except for the UPMIFA requirements and the guidelines regarding distribution of principal or borrowing from the donor-restricted endowment fund as set forth in detail above, Montalvo's distribution guidelines may be modified at the sole discretion of the Board of Trustees as may be necessary to meet the needs of Montalvo.

Endowment net asset composition by type of fund as of September 30, 2012 is as follows:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	<u>\$39,558</u>	<u>\$8,651,373</u>	<u>\$8,690,931</u>

Changes in endowment net assets for the year ended September 30, 2012:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -	\$13,273	\$ 751,257	\$ 764,530
Contributions	-	-	6,400,116	6,400,116
Change in donor-imposed restrictions	-	-	1,500,000	1,500,000
Dividends and interest	-	7,121	-	7,121
Net realized and unrealized gain	-	<u>19,164</u>	-	<u>19,164</u>
Endowment net assets, end of year	<u>\$ -</u>	<u>\$39,558</u>	<u>\$8,651,373</u>	<u>\$8,690,931</u>

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10. Contributions In-Kind

The estimated fair value of donated supplies, furniture, equipment, expert services and facilities are recorded as contributions. During the year ended September 30, 2012, the following in-kind contributions were received by Montalvo:

Media sponsorship	\$452,975
Donated property and equipment	107,676
Special events	83,256
Legal services	33,898
Other (individually less than \$25,000)	<u>111,470</u>
Total contributions in-kind	<u>\$789,275</u>

Montalvo recorded expenses totaling \$681,599 and capitalized property and equipment totaling \$107,676 related to in-kind contributions during the year ended September 30, 2012 as reflected in the accompanying statement of functional expenses and statement of cash flows, respectively.

During the year ended September 30, 2012, Montalvo also received donated services from volunteers that do not require specific expertise but which are nonetheless central to Montalvo's operations. During the year ended September 30, 2012, volunteers and the Montalvo Service Group contributed 15,952 hours of services in support of cultural arts activities. The estimated value of volunteer hours based on the nature of the service and the amount of time donated is estimated to be \$347,597. In accordance with generally accepted accounting principles the value of these services is not reflected in the financial statements.

11. Related Party Transactions

Montalvo's volunteer executive board members are active in both the oversight of the fundraising events, activities and making private contributions. Contributions received from the board of trustee members were approximately \$7,860,159 (\$7,760,140 net of present value discount) for the year ended September 30, 2012.

12. Employee Benefit Plan

During 2000, Montalvo established a defined contribution plan for all eligible employees who are 18 years or above and has completed three months of service. Montalvo is allowed to make a discretionary contribution equal to 3% of all eligible employees' compensation. No contribution was made to this plan for the year ended September 30, 2012.

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13. Montalvo Service Group

The Montalvo Service Group (the "MSG") was established in 1954. Its primary purpose is to provide financial assistance to Montalvo. The MSG is an internal part of Montalvo, but operates under separate bylaws as a committee of Montalvo. During the year ended September 30, 2012, cash of approximately \$69,000 was transferred by the MSG to Montalvo primarily for purposes of repairing and upgrading the East Entrance and Cottage 3.

14. Subsequent Events

Montalvo has evaluated subsequent events through January 16, 2013, the date the financial statements were available to be issued. On October 1, 2012, Montalvo received a \$5,000,000 unconditional promise to give in response to Montalvo's centennial campaign. The promise is scheduled to be collected in five equal annual installments beginning September 30, 2013. In addition, as noted in Note 7, on January 15, 2013, Montalvo renewed its line of credit for additional twelve months with no changes in terms or conditions. There were no other material subsequent events that required recognition or additional disclosure in these financial statements.